ST 02-0009-GIL 01/14/2002 COMPUTER SOFTWARE

Licenses of computer software that meet the requirements set out in 86 Ill. Adm. Code 130.1935(a)1(A-E) constitute nontaxable licenses of software. (This is a GIL).

January 14, 2002

Dear Xxxxx:

This letter is in response to your letter dated October 18, 2001. We apologize for the delay in responding to your inquiry. Because your corporation is currently involved in the Department's Voluntary Disclosure Program, we will not issue a Private Letter Ruling regarding transactions that be at issue in that Program. We are providing you with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120 subsections (b) and (c), which can be found at http://www.revenue.state.il.us/legalinformation/regs/part1200.

In your letter, you have stated and made inquiry as follows:

As a followup to the Application for Voluntary Disclosure, prior to us preparing tax returns, including payment for any period of time, we need a ruling as to what of our sales are subject to Illinois 'sales' taxation. Accordingly, we have prepared the following request and submitted appropriate documentation of our software licensing and maintenance agreements.

REQUEST FOR RULING -VOLUNTARY DISCLOSURE PROGRAM

INTRODUCTION:

AAA hereby requests the Department to consider the form and content of our primary Illinois transactions. We are asking for guidance for the presentation of our voluntary disclosure and current 'Illinois sales and use tax' transaction compliance with our many Illinois customers.

We have initiated sales collection during 2001, and had a steady stream of objections and refusals to pay sales tax as the Illinois-based companies purchase similar items from other vendors and have their expectations of non-taxability and also experience of non-taxation by other vendors.

AAA is a developer of CADD software (computer assisted design and development), substantially used by governments, large companies, architects and engineers, and others that have responsibility for large project construction. Almost every state use this software, for example. Far more information about AAA and our products is available on our Internet site

PRODUCT:

Facts:

PRODUCT is usually marketed through regional and local third parties, and the initial list price cost per 'license' of PROGRAM - our most predominant program is about $$$. There is no 'consumer' distribution as might occur with broadly distributed consumer products or even by one of our largest competitors. All product is 'sold' to identified purchasers, and the serial number is recorded. In reality, it is a perpetual license for a single user.

We are enclosing a copy of the 'End User License Agreement'.

Application of Illinois Rules:

The Illinois statutes and regulations set forth several standards at Section 130.1935, last amended in October 2000, and there have been several publicized rulings. We are listing our facts and how they mesh with regulation section a)1) establishing a nontaxable retail sale:

A. Written agreement signed by the licensor and the customer.

   Essentially all of our licenses are preceded by a written purchase order signed by the customer, and accepted by AAA. Many of our licenses evolve from additional purchases incorporated into our “Agreement' contracts. Also, please see Exhibit B, paragraphs 1.01 and 1.02 of the blank agreement.

B. Restriction of the customer's duplication and use of the software.

   See RESTRICTIONS. paragraph in the License.

C. Prohibition on transfer.

   See RESTRICTIONS. paragraph in the License. As a matter of course, our Legal Group monitors eBay and other methods of resale to enforce this wording.

D. Replacement at no or minimal charge (or under the new reg., authority to make an archival copy).

   See RESTRICTIONS. paragraph in the License.

E. Requirement that the customer destroy or return all copies at the end of the license period.

   See TERM. paragraph in the License.

Proposed Conclusion and Ruling:

AAA's 'sale' of product licenses meets the requirements of Sec. 130.1935(a) and are not taxable retail sales under the Illinois Retailers' Occupation Tax.

NAME:

Facts:

NAME is a subscription agreement whereby AAA promises for a periodic fee to provide support by means of phone assistance and internet web site assistance. Also as a part of the Agreement is a update and upgrade component which allows the customer to check for and download these program modifications. There is no periodic shipment of discs, but rather a customer can request a custom pressing of these modifications, and in reality approximately 10-15% of the 'seats' do so.

We are enclosing a blank copy of our 'Agreement', and please note that in many clauses (i.e. Exhibit B - para. 1.01 and 1.02) it also includes the 'End User License Agreement.'

Application of Illinois Rules:

The Illinois statutes and regulations set forth a standard at Section 140.301(b)(3), last amended in March 2001, and there have been several publicized rulings. We are listing our facts and how they mesh with that regulation and the aforementioned Section 130.1935(a) establishing a nontaxable retail sale:

1. This is predominantly a contract to provide services, remotely, without entry into Illinois, and not upon any tangible property, per se.

2. This is not a software update service, similar to what perhaps tax or data publication services might offer on a monthly, quarterly, or other interval basis.

3. There is a component of tangible property, however, this clearly falls within the Section 130.1935(a) standard, in that each item directs to a finding of non-taxation. There would be a component of use tax.

Proposed Conclusion and Ruling:

AAA's 'sale' of maintenance agreements meets the requirements of Secs. 140.301(b)(3) and 130.1935(a) and are not taxable retail sales under the Illinois Retailers' Occupation Tax.

That AAA's use of CDs (or other earlier media) in the performance of the program is subject to the 'use' tax component of the Illinois Sales and Use Tax provisions.

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We thank you for your patience with us and for your consideration of this request as we strive to comply with the tax rules of Illinois and many other states.

DEPARTMENT'S RESPONSE:

Generally, sales of "canned" computer software are taxable retail sales in Illinois. However, if the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. See subsection (c) of the enclosed copy of 86 Ill. Adm. Code 130.1935.

Sales of software are taxable regardless of the means of delivery. For instance, the transfer or sale of canned computer software downloaded electronically would be taxable.

Custom computer programs or software are prepared to the special order of the customer. The selection of pre-written or canned programs assembled by vendors into software packages does not constitute custom software unless real and substantial changes are made to the programs or creation of program interfacing logic. See subsection (c)(3) of Section 130.1935.

If transactions for the licensing of computer software meet all of the criteria provided in subsection (a)(1) of Section 130.1935, neither the transfer of the software or the subsequent software updates will be subject to Retailers' Occupation Tax. A license of software is not a taxable retail sale if:

A) It is evidenced by a written agreement signed by the licensor and the customer;

B) It restricts the customer's duplication and use of the software;

C) It prohibits the customer from licensing, sublicensing or transferring the software to a third party (except to a related party) without the permission and continued control of the licensor;

D) The licensor has a policy of providing another copy at minimal or no charge if the customer loses or damages the software, or permitting the licensee to make and keep an archival copy, and such policy is either stated in the license agreement, supported by the licensor's books and records, or supported by a notarized statement made under penalties of perjury by the licensor; and

E) The customer must destroy or return all copies of the software to the licensor at the end of the license period. This provision is deemed to be met, in the case of a perpetual license, without being set forth in the license agreement.

Charges for updates of canned software are fully taxable pursuant to Section 130.1935. If the updates qualify as custom software under subsection (c) of Section 130.1935, they may not be taxable. But, if maintenance agreements provide for updates of canned software, and the charges for those updates are not separately stated and taxed, then the whole agreement would be taxable as sales of canned software.

The "End User License Agreement" attached to your letter indicates that it becomes effective when the customer clicks "yes, continue," opens the software package and/or documents, downloads and/or installs the software and/or documentation, or otherwise uses or copies the software and/or documentation. This does not generally constitute a written agreement signed by the licensor and the customer for purposes of subsection (a)(1)(A) of Section 130.1935 described above. You have not provided any documentation that the purchase order signed by the customer incorporates the licensing provisions of the "End User License Agreement."

Based upon the documentation attached to your letter, the sales made through the use of the "Program Agreement" are under the license terms of that agreement, rather than the "End User License Agreement."[1] The "Program Agreement" would constitute a written agreement signed by the licensor and the customer for purposes of subsection (a)(1)(A) of Section 130.1935 described above and also appears to contain most of the other requirements of subsection (a)(1) of that Section. However, we cannot ascertain whether the Program Agreement provides for the customer to receive

another copy of the software at minimal or no charge if the customer loses or damages the software. The Agreement references the grant of a license to make and use only one copy of the product from the product library (Paragraph 7 of Exhibit B of the Program Agreement). We located no provision in the Agreement that allows the customer to maintain an archival copy of that software. Unless the seller can establish by its books and records, or by a notarized statement, that the licensor has such a policy, then we are unable to confirm that the Program Agreement qualifies as a nontaxable license of computer software. See subsection (a)(1)(D) of Section 130.1935.

I hope this information is helpful. The Department of Revenue maintains a website, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b) described above.

Very truly yours,

Terry D. Charlton
Associate Counsel

TDC:msk
Enc.

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[1] Paragraph 1.01 of Exhibit B of the Program Agreement governing existing licenses states that, "this Agreement shall supercede and replace all license agreements existing as of the Effective Date for Products…. The use by Subscriber of all such Products shall hereafter be governed by the terms of this Agreement." Paragraph 1.02 of Exhibit B of that Agreement governing future licenses states that, "In the event that Subscriber hereafter acquires or licenses a copy of a Product, including but not limited to a AAA shrink-wrapped kit containing a Product, Subscriber's use of such Product shall be governed by the terms of this Agreement in effect at the time of such purchase, notwithstanding any other written license agreement from AAA that may accompany such Product."